

DEPARTMENT OF STATE REVENUE

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LETTER OF FINDINGS NUMBER: 04-970008

Sales and Use Tax

For The Period: 1993 Through 1995

NOTICE: Under IC 4-22-7-7, this document is required to be published in the Indiana Register and is effective on its date of publication. It shall remain in effect until the date it is superseded or deleted by the publication of a new document in the Indiana Register. The publication of this document will provide the general public with information about the Department's official position concerning a specific issue.

ISSUES

I. Sales Tax - Unitary Transactions

Authority: IC 6-2.5-1-1; IC 6-2.5-1-2; IC 6-2.5-4-1; 45 IAC 2.2-1-1; 45 IAC 2.2-4-1; Chrome Deposit v. Dept. of State Revenue, 557 N.E.2d 1110 (Ind. Tax 1990); Cowden & Sons v. Dept. of State Revenue, 575 N.E.2d 718 (Ind. Tax 1991).

The taxpayer protests the proposed assessment of sales tax.

II. Sales Tax - Mark-ups

Authority: IC 6-2.5-2-1; IC 6-2.5-4-1; 45 IAC 1-1-54

The taxpayer protests the proposed assessment of sales tax.

III. Tax Administration - Penalty

Authority: IC 6-8.1-10-2.1

The taxpayer protests the proposed assessment of the negligence penalty.

STATEMENT OF FACTS

The taxpayer operates an advertising agency with its office located in Indiana. The agency offers a range of advertising services, including services relating to written literature, such as brochures and catalogs. The services offered by the taxpayer regarding printed materials include consultation and supervision of the preparation and production of printed material. The taxpayer does the design and setup work for these items and then has these items printed elsewhere. The taxpayer paid sales tax when these printed items were purchased. The taxpayer then marked up the printed items and stated setup and design charges separately. The taxpayer listed the sales tax paid on the printing as "sales tax on materials," and passed the tax paid onto the client.

I. Sales Tax - Unitary Transaction

DISCUSSION

A unitary transaction includes all items of personal property and services furnished under a single order or agreement and for which a total combined charge or price is calculated. IC 6-2.5-1-1(a).

Taxpayer argues that since the services are separately stated and divisible from the transfer of property, sales tax does not apply. Taxpayer relies upon Information Bulletins #14 which states that, "Income derived by advertising agencies for services rendered is not taxable under the Sales Tax Act." Therefore, the taxpayer argues that any services rendered in connection with advertising materials are exempt from tax.

The audit relied upon 45 IAC 2.2-1-1 to assess sales tax upon the service charges. A unitary transaction according to this regulation includes ". . . all items of property and/or services for which a total combined charge or selling price is computed for payment irrespective of the fact that services that would not otherwise be taxable are included in the charge or selling price." The audit postulated that the taxpayer must collect sales tax on the *entire* charge, including setup and design, pursuant to 45 IAC 2.2-4-1(b), which states that all elements of consideration are included in gross retail income subject to tax including ". . . any additional bona fide charges added to or included in such price for preparation, fabrication, alteration, modification, finishing, completion . . ."

The Department further argues that the services in dispute (printed promotional materials) come within the holding of Chrome Deposit v. Dept. of State Revenue, 557 N.E.2d 1110 (Ind. Tax 1990). By way of illustration, the Department points to the taxpayer's invoice for an order received on October 19, 1995, for business cards, letterheads, and envelopes. The taxpayer charged its customer for logo design, filled the order and was paid for it on November 2, 1995. The substance of the transaction was the tangible personal property being sold. By applying the "but for" test announced by the Tax Court in Chrome Deposit, the facts would seem to indicate that *but for* the intent of the customer to buy the printed materials, the taxpayer would not have developed the logo design.

The Department also notes that Cowden & Sons v. Dept. of State Revenue, 575 N.E.2d 718 (Ind. Tax 1991), is also controlling. The Tax Court in Cowden announced that "the legislature intends to tax services rendered in retail unitary transactions only if the transfer of property and rendition of services is inextricable and indivisible." Cowden at 722. The Tax Court then stated "the divisibility of a transaction is indicated by the temporal relationship between the provision of the services and the transfer of the property . . . services performed prior to a transfer of

property indicate an inextricable transaction wholly subject to sales tax” *Id.* If we apply the above cited case law to the taxpayer, we find that any charges for services are being performed before the transfer of the property. Therefore, according to the Department, any charges for these services are subject to sales tax because the transaction is inextricable under Indiana Code 6-2.5-4-1(e)(2).

FINDING

The taxpayer’s protest is denied.

II. Sales Tax - Mark-ups

DISCUSSION

The taxpayer further protests the assessment of tax on markups. The fact that the taxpayer calls itself an advertising agency does not mean that any and all services that the taxpayer performs are therefore “advertising services.” The Department contends that the same analysis that applied to issue one—unitary transaction—applies to the “mark-ups” as well. The Department supplements that analysis with an analysis of agency law under 45 IAC 1-1-54. To determine whether the taxpayer is acting as an agent a two-step analysis is necessary. First the taxpayer must be a true agent. The Indiana Administrative Code defines an agency relationship as manifestation of consent by one person to another authorizing the other to act on his behalf and subject to his control. After the requirement that the principal’s control over the acts of the agent throughout the entire contract is satisfied, the next step is whether the agent had any right, title or interest in the property received or transferred as an agent. An agent is to act as a conduit, and the “income received for work done or services performed on behalf of a principal must pass intact” to the principal or client.

The taxpayer purchases materials and then bills the client at a mark-up. The taxpayer does not impose tax on the mark-up or profit margin, but does pass on the tax paid at the point of purchase. The taxpayer argues that as an agent it merely transfers property purchased on behalf of its clients. Information Bulletin #14 states, in part, the following:

If an agency relationship exists between the advertising agent and his client the agent may pay the sales tax for the principal when the advertising agency makes purchases of personal property in the client’s behalf in the process of performing his services, (e.g., printing plates, photographs, advertising brochures). He may then seek reimbursement from the client at the time of billing.

The taxpayer protests that the materials always belong to the client and are never the properties of the taxpayer. The taxpayer argues that it is under the direction of its client, with the client exercising complete control over the content, style, form, timing and cost of printed material. The auditor found, and the Department concurs, that a mark-up by the taxpayer over the amount paid for materials is inconsistent with an agency relationship and evidences an interest in the materials. The Department’s position is consonant with its position on issue one—unitary transactions.

FINDING

Taxpayer’s protest is denied.

III. Tax Administration - Penalty

DISCUSSION

The taxpayer protests the assessment of the ten percent negligence penalty. The negligence penalty imposed under IC 6-8.1-10-2.1 subjects a taxpayer to a ten percent penalty if the taxpayer incurs a deficiency that is due to negligence. However, the penalty shall be waived if the taxpayer shows the deficiency was due to reasonable cause and not due to willful neglect. The taxpayer has shown reasonable cause for the deficiency.

FINDING

Taxpayer’s protest is sustained.